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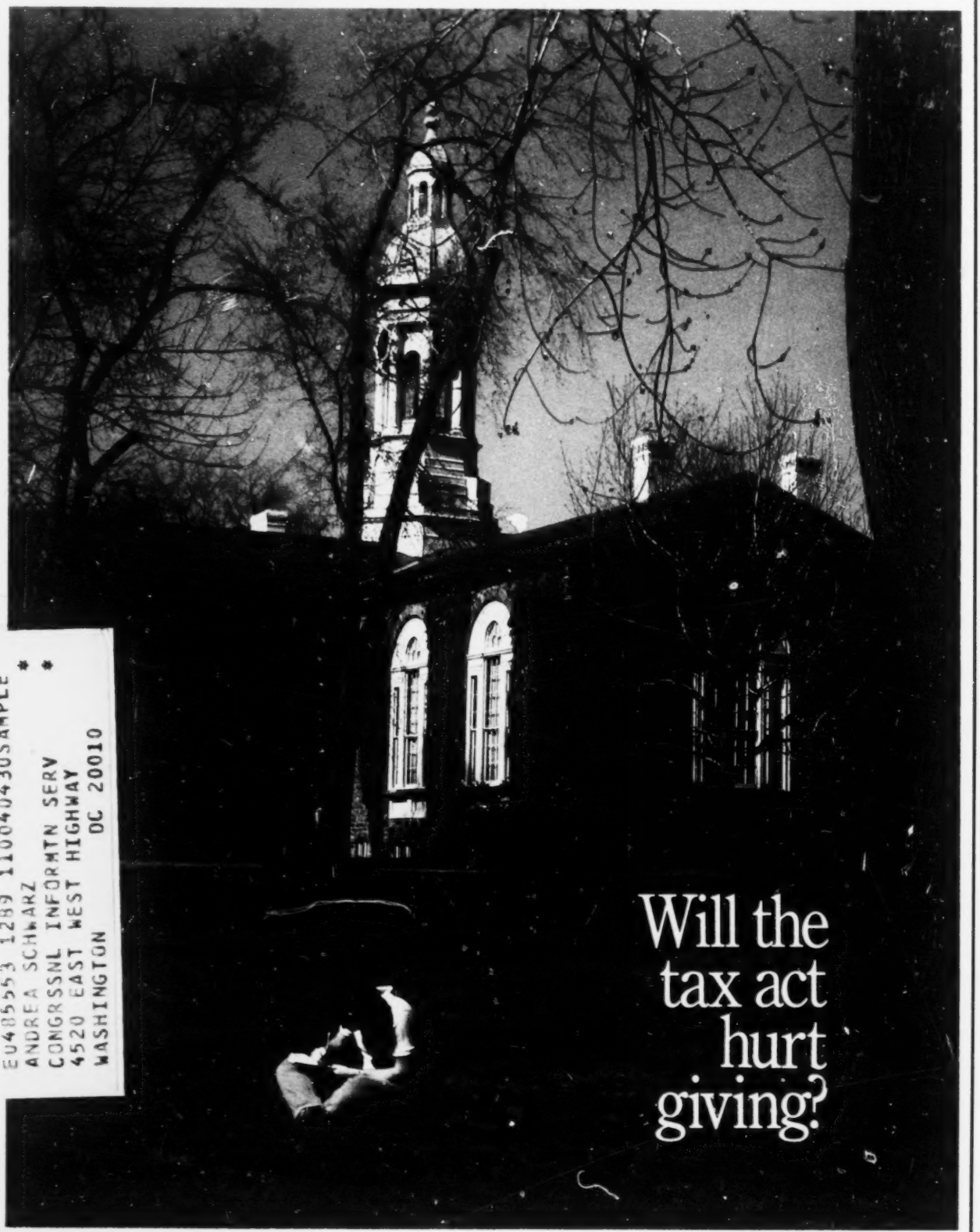
TRUSTS & ESTATES

ESTATE PLANNING & ADMINISTRATION

A Publication of Communication Channels, Inc. DECEMBER 1981



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Will the tax act hurt giving?

TRUSTS & ESTATES

Volume 120, No. 12 DECEMBER 1981

Estate Planning and Administration Since 1904

8 **Will the Tax Act Hurt Giving?**
The impact on charitable giving — *Lester Salamon, Charles T. Clotfelter*

16 **Tax Act May Not Hurt Charitable Giving**
The new law will leave individuals with more money to support their favorite charitable causes — *Jonathan G. Tidd*

21 **Legacies to Preserve the Environment**
Bankers Trust Co. and The Nature Conservancy team up to preserve the environment — *John M. Stewart, Patrick F. Noonan*

26 **Planned Giving to Heirs and Charitable Institutions**
The charitable lead trust is an impressive estate planning strategy — *Charles W. Collier*

29 **The Elective Deferral of Payment of Estate Taxes**
It is only a matter of time before many estates are pushed into taxable brackets — *David W. Hardee*

35 **Tax Act Has Far-Reaching Impact on Unified Credit**
Unified credit to be phased in over six years — *Judith W. McCue*

39 **ERTA Makes Changes but Role for Life Insurance Remains**
The irrevocable trust continues to grow in popularity as a vehicle for owning life insurance — *John R. Howard Jr., Hillery J. Gallagher*

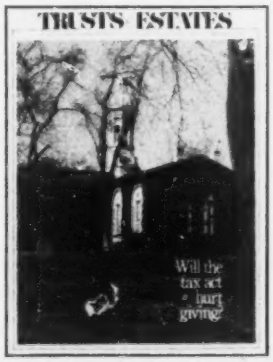
44 **Special Use Valuation: How Will it Be Affected by the Tax Act?**
The reaffirmation of the role of special use valuation — *Robert M. Bellatti*

53 **Selecting Trustees for Trusts Subject to Generation-Skipping Tax**
Should an individual or a corporate trustee be appointed? — *John F. Meigs*

59 **Exclusions Expanded**
New uses for 'Crummey' trusts contemplated — *Charles F. Newlin*

67 **Managing the Family Business**
The trust department is ally of the business owner — *Donly F. Chase*

71 **Administering the Closely Held Business**
A bank's growing responsibility — *Richard H. Rice*



THE COVER

The effect of the tax act on charitable contributions is unclear at the moment. A debate is brewing, however, on what the effect will be for private educational institutions, hospitals, and charities dependent in part on such gifts. The cover photograph is of Princeton University's Cannon Green and Nassau Hall. (Courtesy of Princeton University's department of communications and publications)

REGULAR FEATURES

4 Commentary
6 Letters to the Editor
76 Law and Life Insurance
78 Trust Taxes
79 Fiduciary Decisions
80 Personnel
81 Meetings

Will the Tax Act Hurt Giving?

The impact on individual charitable giving

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On August 13, 1981, President Reagan signed into law the Economic Recovery Tax Act of 1981, one of the central pillars of the economic program he had unveiled six months earlier.

The purpose of this report is to assess the probable impact of this new tax law on individual charitable giving over the next several years. This impact is worth exploring not simply because of the magnitude of the resources involved, but even more so because of the special role that charitable giving plays in the private, nonprofit sector of American life, and because of the special implications it consequently has for the administration's overall economic strategy.

The nonprofit sector is a vast amalgam of organizations, ranging from museums, arts societies, universities and civic clubs, to social welfare agencies, neighborhood organizations, public interest groups and churches. Historically supported largely from private sources, these organizations have come to rely increasingly over recent years on government support and commercial revenues and fees. Of the $85.3 billion in expenditures that nonreligious nonprofit organizations reported in 1977, for example, only $19.1 billion, or 22 percent of the total, came from private giving.[1] Yet, it is still private contributions that give these organizations their distinctive character as independent, private institutions performing essentially public purposes. With private giving so small a share of nonprofit revenues, therefore, anything that threatens private giving threatens the very essence of the nonprofit sector.

The potential impact of the 1981 tax act on private giving takes on special meaning, however, in the context of the broader economic strategy being pursued by the current national administration. One of the central tenets of this strategy, of which the tax act is a pivotal part, is that the role of government should be reduced and the private sector encouraged to fill whatever real gap in services occurs as a result. To the extent that the tax act turns out to discourage such private action by discouraging private giving, it would pose a significant challenge to this strategy and add further strain to nonprofit organizations already burdened by budget cutbacks. Under these circumstances, it becomes all the more urgent to assess what the impact of this act on charitable giving is likely to be.

The Analytical Problem

Carrying out such an assessment is far from simple, however. In the first place, as noted in Table 1, the 1981 tax act contains not one, but a number of features that are likely to affect the level of giving. In addition, many of these have multiple effects that sometimes operate at cross-purposes. Finally, giving behavior is also affected by general economic conditions that may, in turn, be affected indirectly by the tax changes.

The reductions in tax rates proposed

Editor's Note: This study was commissioned and funded by the Independent Sector, an organization created to preserve and enhance the national tradition of giving, volunteering and not-for-profit initiative. It was conducted by The Urban Institute, a nonprofit policy research and educational organization established in Washington, D.C. in 1968. The study is reprinted with the permission of the Independent Sector.

in the 1981 act provide a useful illustration of the problem. In the first place, these reductions will automatically increase after-tax income, which should encourage giving. In addition, it has been suggested that the reductions will help stimulate economic activity, which should increase before-tax incomes and thus further encourage giving. However, lower tax rates also mean an increase in what economists term the "price of giving," the net, out-of-pocket cost of giving a dollar to charity. Because charitable contributions are deductible from income in computing tax obligations, it does not really cost those who itemize their deductions a full dollar to contribute a dollar to charity. In fact, the higher the tax bracket, the lower the real cost of giving. For a taxpayer in the 70 percent tax bracket, for example, the actual, out-of-pocket cost of giving a dollar to charity (the price of giving) is really 30 cents, since 70 cents would have gone to the federal government anyway. Reduce that tax rate to 50 percent, and the price of giving that same dollar to charity rises to 50 cents, an increase of 67 percent.

By reducing the maximum tax rate on unearned income from 70 percent to 50 percent and cutting marginal tax rates by 25 percent, the 1981 act promises to have effects of precisely this kind. At the same time, however, the act will permit those who now use the standard deduction to claim deductions for their charitable contributions while still taking the standard deduction. This provision, which goes into effect in stages between 1982 and 1986, will lower the price of giving for these taxpayers, and thus encourage giving.

Inflation and Bracket Creep

In addition to these tax-rate effects, charitable giving is also affected by inflation and economic growth, which increase before-tax income, shift some taxpayers into higher tax brackets and induce some taxpayers who now take the standard deduction to itemize their deductions instead, reducing their cost of giving and thus encouraging them to give more. This latter effect may be offset, however, by a provision in the 1981 law that will adjust the tax code for inflation in 1985 and thereby reduce this process of bracket creep.

To capture the full effects of the 1981 tax act on charitable giving, therefore, it is necessary to sort out and assess a wide assortment of relationships, and take account of the interactions among them. To do so, it is helpful to differentiate two broad kinds of effects that are at work. The first are *price effects*, which influence the cost of giving. Included here are changes in tax rates, as well as changes in income that move taxpayers into different tax brackets or affect their decisions on whether to itemize deductions. The second are *income effects*, or features that affect the income available for charitable giving. Included here are changes in general economic conditions that affect the level of before-tax income, and changes in tax rates that affect the level of after-tax income. A complete assessment of the impact of the 1981 law must take both of these kinds of effects into account.

The Approach

To do this, a simulation model of taxpayer charitable-giving behavior was developed, drawing on econometric studies spanning more than a decade.[2] The studies have established the existence of strong, independent links between levels of giving, on the one hand, and changes in the tax-defined price of giving and in income levels, on the other. While these factors are hardly the only ones that affect levels of giving, they have consistently been found to have a sizeable impact that can be estimated with some precision.

A full specification of the methodology that underlies this analysis is available in the technical appendix to this report. Certain key features and limitations of the approach deserve attention here, however, to clarify the discussion that follows.

- *Focus on giving by living individuals.* In the first place, the analysis here focuses exclusively on the impact of the 1981 tax law on charitable giving by *living individuals* (the items marked with an asterisk in Table 1). It does not examine the potential impact of the law on the other three sources of private giving: foundations, corporations, and bequests. This approach is dictated by the absence of reliable analyses of the giving behavior of these other three sources and is further justified by the fact that individual giving accounts for more than 80 percent of total private giving.

At the same time, however, this focus probably *understates* the potential *neg-*

Table 1

Key Features of the Economic Recovery Tax Act of 1981 Affecting Charitable Giving

Factors Likely to Discourage Giving
- Reduction in the Maximum Tax Rate on Unearned Income from 70 Percent to 50 Percent*
- Across-the-board 25 Percent Reduction in Marginal Tax Rates Over Three Years*
- Reduction in Capital Gains Tax Rate from 28 Percent to 20 Percent*
- Liberalization of Estate Taxation
- Indexation of Tax Rates and the Standard Deduction Beginning in 1985*
- Modification of Foundation Payout Requirements
- Reduction in Corporate Income Taxation through Liberalization of Depreciation Provisions

Factors Likely to Encourage Giving
- Charitable Deductions for Non-Itemizers*
- Increase in Maximum Allowable Corporate Contributions

*Indicates items that affect individual giving, as opposed to giving by foundations, corporations, or estates.

Table 2

Projected Individual Giving, 1981-84, 1981 Tax Act vs. Pre-1981 Law, Actual Dollars ($ billions)

	Pre-1981 Law (Carter Economic Assumptions)	1981 Tax Act (Reagan Economic Assumptions)	Difference	
			Amount	% Change
1981	$ 45.0	$ 44.5	−$ 0.5	− 1.1%
1982	52.4	49.1	− 3.3	− 6.3
1983	60.2	54.7	− 5.5	− 9.1
1984	70.5	61.5	− 9.0	−12.8
Total	$228.1	$209.8	−$18.3	$− 8.0%

Table 3

Projected Individual Giving, 1981-84, 1981 Tax Act vs. Pre-1981 Law, in Constant 1980 Dollars ($ billions)

	Pre-1981 Law	1981 Tax Act	Difference	
			Amount	% Change
1981	$ 40.8	$ 40.5	-$0.3	-0.7%
1982	43.4	41.3	- 2.1	-4.8
1983	46.0	42.9	- 3.1	-6.7
1984	49.9	45.5	- 4.4	-8.8
Total	$180.1	$170.2	-$9.9	-5.5%

ative impact of the 1981 tax law on charitable giving. This is so because the new tax law contains three features that are likely to discourage these other forms of giving. In the first place, bequest giving is likely to be adversely affected by the act's virtual elimination of taxation of estates, which will significantly reduce the tax incentives for charitable bequests. In the second place, corporate giving is likely to be adversely affected by the new law's massive reform of depreciation rules, which will reduce taxable corporate profits and lower corporate tax rates. Finally, giving by foundations is likely to be reduced because of the law's easing of the so-called payout requirement imposed on private foundations by the 1969 tax act.[3]

In short, although the exclusive focus on individual giving means that the present analysis covers close to 85 percent of all private giving, it nevertheless leads to some understatement of the likely negative impacts of this law.

• *1981-84 time frame.* A second potential source of underestimation results from the choice of time period covered in this analysis. Because of the difficulty of accurately projecting economic conditions too far into the future, the analysis here is limited to the 1981-84 period for which estimates of economic conditions are more readily available.

One of the consequences of this choice of time frame, however, is to leave out of the analysis one of the features of the 1981 act that may have the greatest impact on charitable giving: the provision indexing tax rates and the standard deduction so that they rise and fall with inflation. This provision is likely to reduce charitable giving by limiting the incentives for taxpayers to begin itemizing their deductions (a move that is normally associated with higher giving). Because this provision is not scheduled to go into effect until 1985, however, it is not treated in this analysis. By contrast, the new law's provision allowing above-the-line charitable deductions for the nonitemizers is likely to begin having noticeable effect by 1984 and is included in our analysis. Using 1984 as the cut-off point therefore probably understates the ultimate negative impact of the new law.

• *Data sources.* The primary source of data for the analysis reported here was the Internal Revenue Service's annual *Statistics of Income*, which summarizes income, deductions, and related data reflected on individual tax returns. While this source is an invaluable tool, it has a number of limitations that must be borne in mind.

In the first place, the most recently published data are for the 1978 tax year. These data therefore had to be "aged," using standard techniques, to bring them up to date. This aging process took account of actual and projected changes in personal income and price levels, but it assumed that the distribution of taxpayers among filing statuses (e.g., single, married filing jointly) remains fairly constant.

In the second place, *Statistics of Income* reports only aggregate data, grouping taxpayers by tax bracket. While a full data tape at the individual unit of analysis is available, for selected years, the lead time required to access this tape made its use impractical. What is more, past research has demonstrated that using aggregate data produces virtually the same results as using individual data. Nevertheless, to improve the sensitivity of the analysis, separate simulations were run for taxpayers in each of the five filing statuses and, within each of these, for itemizers and nonitemizers separately.

In the third place, *Statistics of Income* provides data on the charitable contributions only of those who itemize their deductions. For nonitemizers, data on charitable contributions were taken from a University of Michigan survey on giving conducted in 1973. These data were "aged," using standard procedures, and checked against more recent, but less complete, surveys. Finally, because appreciated assets are taxed differently from regular income (they are taxed at special capital gains rates), reported contributions had to be divided between cash and other assets and separate analyses done on each. Since the most recent available breakdown of contributions in these terms is in the 1975 *Statistics of Income* (Table 2.4, p. 52), this source had to be "aged" to make it consistent with the other data. This process assumed, however, that the share of contributions that took the form of cash as opposed to appreciated assets remained roughly the same between 1975 and 1981.

• *Economic assumptions.* In projecting the impacts of the 1981 tax act, the analysis here takes as given the assumptions about income growth and price behavior projected by the Reagan administration in its March 1981 *FY 82 Budget Revisions*. This approach gives full credence to the economic impacts attributed to the tax bill by its supporters.

In projecting the levels of giving that

Table 4

Projected Individual Giving, 1981-84, 1981 Tax act vs. Pre-1981 Law, Reagan vs. Carter Economic Assumptions, Current vs. Constant Dollars ($ billions)

	Basis for Comparison with 1981 Law			
	Current Dollars Pre-1981 Law With		Constant 1980 Dollars Pre-1981 Law With	
	Carter Assumptions	Reagan Assumptions	Carter Assumptions	Reagan Assumptions
1981	-$ 0.5	-$ 0.3	-$0.3	-$ 0.3
1982	- 3.3	- 2.8	- 2.1	- 2.3
1983	- 5.5	- 5.0	- 3.1	- 3.9
1984	- 9.0	- 5.8	- 4.4	- 4.3
Total	-$18.3	-$13.9	-$9.9	-$10.8

would have resulted had the pre-1981 law remained in effect, by contrast, the economic assumptions of the previous administration were used, since they were based on the continuation of this pre-1981 law. For purposes of comparison, however, the effects of the pre-1981 law were also projected using the Reagan administration's assumptions.

Because of the sensitivity of this analysis to estimates of income growth and price changes, the dollar estimates of contributions reported here may change if the relevant economic assumptions fail to materialize. In all likelihood, however, the comparisons between policies will not be affected.

• *Basis for comparison.* In order to provide some frame of reference, the levels of charitable giving projected for 1981-84 under the 1981 tax act had to be compared to some reference point. Generally speaking, the frame of reference utilized by the Reagan administration in discussing the impact of its proposals compares the projected effects of the new law under the administration's March 1981 economic assumptions to the effects that would have resulted from the continuation of the prior law under the prior administration's economic assumptions. This approach gives the maximum benefit of the doubt to those who argue that the Reagan Economic Recovery Program, of which the tax bill is a central part, will significantly change the performance of the economy; and it is generally the approach utilized here. Rather than report this comparison only in current dollar terms, as is typically done, however, we also report them in constant 1980 dollars to avoid overstatement.

Beyond this, three other bases of comparison are also introduced for illustrative purposes. First, the results under the pre-1981 law were calculated using the Reagan, rather than the Carter, economic assumptions. Second, the results under the 1981 law were compared to the results that would have occurred under the House Ways and Means Committee version of the tax bill. Finally, the results anticipated under the 1981 law from 1981 through 1984 are compared to actual levels of giving recorded from 1976 through 1980, the most recent historical period.

Because each of these reference points taps a somewhat different dimension of reality, introducing all three can help minimize misleading impressions and convey the full character of the changes in individual giving associated with the 1981 act.

• *The simulation technique.* Ultimately, the analysis presented here is based on a simulation model that expresses individual giving behavior in mathematical terms as a function of income levels, and the price of giving, including projected changes in itemization status.[4] The basis model reflects econometric studies spanning more than a decade that have made substantial progress in explaining the impact of taxes on giving behavior. An effort has been made here to utilize estimates for the key parameters of the model, such as the degree of responsiveness of giving to changes in the price of giving, that are well within the ranges found in the literature.

While every effort was made to present as balanced and fair a picture as possible, it should be noted that some important assumptions nevertheless underlie the approach. In the first place, the key parameters in the model are built on behavioral relationships observed over the past. They assume, in other words, that the existing relationships among giving, income levels, and the price of giving will largely remain constant over the foreseeable future, and that major changes will not occur in the basic determinants of charitable behavior. Even if such a major change in giving occurs, however, the analysis presented here should still be of value as a standard against which to assess the extent of this change.

Similarly, the present model does not make any allowance for a lag between changes in tax law and projected changes in giving behavior. Whether such a lag generally exists or not is a matter of debate, but it seems less likely for a tax change as well publicized and hotly debated as the 1981 tax law than for other, more subtle changes in tax law.

• *No assessment of the substantive merits of the tax cut.* Finally, it should be clear that no attempt is made here to assess the substantive merits or drawbacks of the 1981 tax bill, either as a whole or with respect to individual features. Nor is any effort made to evaluate the claims and counterclaims about the overall economic impact of this act. The objective here, rather, is the more narrow one of estimating the scale and direction of the impact of this complex bill on just one small, though vitally important, feature of economic life: charitable giving by individuals. In this way, the study seeks to serve the goal of increasing our understanding of the full consequences of this major policy innovation, even those that are unintended or inadvertent.

Against this backdrop of considerations, it is now possible to turn to an examination of the probable impacts of the 1981 tax law on charitable giving.

Table 5

Projected Individual Giving, Pre-1981 Law vs. 1981 Tax Act and House Ways and Means Committee Tax Bill, 1981-84, in Actual Dollars ($ billions)

	Difference between giving under pre-1981 Law and:	
	1981 Law	*House Ways and Means Committee Bill*
1981	-$ 0.5	-$ 0.1
1982	- 3.3	- 2.0
1983	- 5.5	- 3.6
1984	- 9.0	- 6.8
Total	-$18.3	-$12.4

The Results

Three sets of results flow from our analysis of the impact of the 1981 tax

Table 6

Trends in Individual Giving, 1976-80 and 1981-84 Projections Under 1981 Law and Pre-1981 Law, in Constant 1980 Dollars

Time Period	Basis	Percentage Increase in Individual Giving
1976-80	Actual	+13.3%
1980-84	1981 Law	+14.0%
1980-84	Pre-1981 Law	+25.1%

Table 7

Individual Giving as a Percent of Personal Income, 1976-80 Actuals and 1981-84 Projections, 1981 Tax Act vs. Pre-1981 Law

Year	1981 Tax Act	Pre-1981 Law
1976	1.92	1.92
1977	1.91	1.91
1978	1.91	1.91
1979	1.89	1.89
1980	1.84	1.84
1981 E	1.85	1.86
1982 E	1.84	1.94
1983 E	1.83	1.99
1984 E	1.88	2.10

NOTE: E = Estimates

act on individual charitable giving. The first of these relates to the aggregate impact of the act on the overall level of individual giving. The second relates to the variation in this impact among different income groups. And the third relates to variations in this impact that result for different types of recipient organizations. Let us examine each of these sets of results in turn.

Aggregate Impacts

Comparisons with pre-1981 law. The central conclusion that emerges from this analysis is that the 1981 tax act will significantly reduce individual charitable giving below the level it would have achieved under the prior law. In particular, as shown in Table 2, individual giving in current dollar terms is projected to be $3.3 billion lower in 1982 under the new law than it would have been under the prior law. This disparity widens over time, moreover, so that the total reduction over the 1981-84 period amounts to $18.3 billion. Expressed in constant 1980 dollars, as shown in Table 3, the new law thus involves a relative decline in individual charitable giving of $2.1 billion in 1982, and $9.9 billion for the period 1981-84.

These results do not change markedly, moreover, when giving under the pre-1981 law is projected using the Reagan economic assumptions rather than the assumptions of the previous administration, as shown in Table 4. Under these circumstances, giving under the new law during 1981-84 is projected to fall $13.9 billion in actual dollar terms, and $10.8 billion in constant dollar terms, below what would have occurred under the prior law.

Whatever the form of comparison, therefore, these results suggest that giving will be less under the 1981 tax law than it would have been under the prior law, and that the extent of this disparity will be $14-$18 billion in actual dollar terms, and about $10-$11 billion in constant dollar terms, over the next four years.

Comparison with House Ways and Means Committee bill: The projected reduction in charitable giving relative to prior law would have been somewhat less severe under the House Ways and Means Committee version of the tax bill than it is projected to be under the bill that passed. As shown in Table 5 the Committee bill would have reduced individual giving during 1981-84 in actual dollar terms by $12.4 billion below that projected under the previous law, compared to $18.3 billion for the approved bill.

In constant 1980 dollars, the reduction in giving associated with the House Ways and Means Committee bill would have been $5.2 billion over the 1981-84 period, compared to $9.9 billion under the tax act that passed.

Comparison with prior levels of giving: To say that individual giving under the 1981 tax act is projected to decline relative to what would have occurred had the prior law remained in force is not, however, to say that giving under the new law will decline in absolute terms. To the contrary, private giving under the new law is projected to exceed actual 1980 levels in real dollar terms throughout the period. In fact, as noted in Table 6, the rate of increase in the real dollar value of individual giving projected for 1980-84 under the 1981 law, though considerably less than what would have occurred under the pre-1981 law, nevertheless is equivalent to the growth rate achieved during the most recent comparable period, 1976-80. In particular individual giving is projected to increase by 14 percent in real dollar terms between 1980 and 1984 under the new law, compared to an actual increase of 13.3 percent between 1976 and 1980.

This result is attributable in substantial part, however, to the unusually high inflation rates in the latter 1970s, which took a heavy toll on the real value of charitable giving during this period. Under these circumstances, a future growth record that merely matches the real growth pattern of the past several years is a modest one indeed. In fact, the growth record projected under the new law will continue a trend begun in the early 1970s for individual charitable contributions to decline as a share of personal income. By contrast, as noted in Table 6, this trend would have been reversed had the previous law remained in effect during 1981-84.

Table 8

Projected Distribution of Individual Giving by Income Groups, 1981 Tax Act vs. Pre-1981 Law, 1981-84, in Actual Dollars ($ billions)

Income Group	Projected Giving, 1981-84		Difference	
	Pre-1981 Law	*1981 Law*	*Amount*	*As % of Total*
Lower[a]	$ 19.2	$ 19.2	-$ 0.1	0.5%
Middle[b]	107.8	103.3	- 4.4	24.0
Upper[c]	101.1	87.3	- 13.8	75.4
Total	$228.1	$209.8	-$18.3	100.0%

[a]Represents the bottom three income tax brackets, which accounted for 30 percent of the taxpayers in 1978.
[b]Represents the middle eight tax brackets, which accounted for 55 percent of all taxpayers in 1978.
[c]Represents the top seven tax brackets, which accounted for 15 percent of all taxpayers in 1978.

Variations Among Income Classes

As important as the overall impact of the 1981 tax act on aggregate levels of charitable giving are the significant variations in this impact among income classes. These variations result from the fact that the 1981 law delivers considerably more tax advantages to upper-income taxpayers than to middle- or

lower-income taxpayers. As a result, the giving behavior of upper-income taxpayers can be expected to be more heavily affected by the new law than that of lower- and middle-income taxpayers.

Table 8 confirms this expectation. What it shows is that a disproportionate share of the reduction in individual giving associated with the new law as opposed to the old is concentrated in the upper income brackets. Representing 15 percent of all taxpayers and 44 percent of all individual charitable contributions in 1978, the taxpayers in these brackets account for 75 percent of the reduction in individual giving associated with the 1981 law as compared with the pre-1981 law over the 1981-84 period.

Put somewhat differently, the 1981 tax act significantly shifts the burden of giving among income groups over the 1981-84 period compared to what it was in 1980. In particular the share of individual giving for the bottom 30 percent of all taxpayers *increases* 2.2 percent between 1980 and 1984 under the 1981 law; and for the middle 55 percent of all taxpayers, it increases 11.5 percent. By contrast, the share contributed by the 15 percent of all taxpayers in the highest income brackets decreases 12.2 percent.[5]

Table 9

Estimated Individual Contributions to Various Types of Charitable Organizations, 1980 vs. 1981 Tax Law Projections, 1981-84, in Constant 1980 Dollars ($ billions)

Type of Organization	1980*	Projected Giving, 1981 Tax Law 1981	1982	1983	1984	% Change 1980-84
Religious	$24.37	$24.87	$25.75	$26.82	$28.58	+17.4%
Other Charitable[a]	5.76	5.84	5.96	6.18	6.53	+13.4
Educational	1.50	1.46	1.38	1.41	1.45	- 3.3
Hospitals	0.64	0.62	0.59	0.60	0.62	- 3.1
Other[b]	7.66	7.67	7.62	7.90	8.32	+ 8.6
Total	$39.93	$40.46	$41.30	$42.91	$45.50	+14.0%

[a] "Other charitable organizations" here includes such organizations as community chests, American Red Cross, and American Cancer Association.
[b] "Other organizations" includes "literary, educational and scientific foundations, libraries, museums, and zoos."
*NOTE: The allocations among recipient types reported here are not comparable to those reported in *Giving U.S.A.* because of differences in definitions of types of organizations used.

Impact Among Recipients

What makes these variations in the impact of the 1981 tax act among income classes particularly important is the fact that different income groups support different kinds of charitable activities. Generally speaking, lower-income groups give proportionally more of their charitable gifts to religious organizations than do the rich, while the rich give proportionally more to educational and cultural institutions. By altering the distribution of charitable giving among different income groups, therefore, the 1981 tax act may have quite uneven implications for different types of charitable organizations.

Fortunately, the U.S. Treasury has compiled a data base that allows us to assess this possibility. Although the data are available only through the early 1960s, they can be "aged" through standard procedures and related to the projects of individual giving generated by our analysis.

Table 9 reports the results of such an analysis. It compares the amount of giving that five different types of charitable organizations can expect under the 1981 law over the 1981-84 period to what they received in 1980. As expected, the impact of the new tax law differs significantly among these different types of organizations. In particular, these projections indicate that religious organizations will absorb 76 percent of the real increase in individual giving projected under the 1981 law during 1981-84. As a result, individual giving to religious organizations is expected to increase by 17.4 percent in real dollar terms between 1980 and 1984. By contrast, individual giving to educational institutions and hospitals is projected to *decline* by more than three percent *below 1980 levels* in real dollar terms during this period. In short, aside from its aggregate effects, the 1981 tax act also promises to have redistributive effects, significantly altering the flow of private charitable funds among different segments of the nonprofit world.

Conclusions and Implications

Summary: the tax bill. The Economic Recovery Tax Act of 1981 has already taken its place as one of the most controversial and hotly debated pieces of economic policy in our nation's history.

To date, however, the debate over this act has largely ignored one of its more important, if indirect, potential consequences: its impact on the rate of private, charitable giving and hence on the strength and viability of the whole private nonprofit sector of national life.

This neglect is especially ironic in view of the fact that one of the central tenets of the economic philosophy reflected in the tax act is the belief that fewer social functions should be vested in government and more reliance placed on private institutions to cope with national needs. Yet the evidence developed here indicates that, at least so far as the nonprofit, charitable segment of the private sector is concerned, the tax bill works in the opposite direction, discouraging private giving and thus limiting the capability of private nonprofit intitutions to assume an expanded role.

The extent of this impact is substantial, moreover. Even after taking full account of the growth, in personal income and the reduction in inflation rates its advocates claim will result from it, the tax bill still promises to reduce charitable giving by $10 billion in constant dollar terms, and $18 billion, in actual dollar terms, between 1981 and 1984 relative to what would have occurred in the absence of the law; and this takes into account only the act's impact on individual giving, not additional reductions in giving that are likely to result from the act's impacts on bequests, foundations, and corporations. To be sure, private giving is still projected to grow in absolute terms during this period, if only because personal income will continue to grow. But the rate of growth promises to be considerably lower than it would have been under the previous law, whatever the economic assumptions, so that private giving as a share of personal income is projected to continue its long-term pattern of decline.

Beyond its aggregate impact, moreover, the 1981 tax act also promises to alter the distribution of contributions among income groups, reducing the relative share contributed by the better-off and leaving a larger share to be borne by the middle and lower-middle classes. In the process, the act will adversely affect some segments of the nonprofit world more severely than others. Giving to educational institutions and hospitals, for example, is not only projected

to grow more slowly but to decline in absolute terms by three percent *below 1980 levels* between 1980 and 1984 as a consequence of this law.

Tax Bill and the Budget

These impacts are all the more significant coming as they do on top of the pressure that will be put on nonprofit organizations as a consequence of the other major half of the economic recovery program: federal budget cuts. Although a full picture of the final cuts approved by Congress is not yet available, earlier analysis, reflecting the cuts originally proposed by the administration, suggested that nonprofit revenues from federal sources will decline by $27.3 billion in current dollars over the 1981-84 time period.[6] Taken together, the budget and tax portions of the Economic Recovery Program are projected to cost nonprofit organizations $8.1 billion in 1982, and $45.6 billion over the 1981-84 period, compared to what would have been available in the absence of these changes. Expressed in constant 1980 dollars, these losses amount to $6.1 billion in 1982, and $31.0 billion over the full four-year period.

Far from allowing nonprofit organizations to expand their services to meet the new demands created by federal withdrawal, private giving under the 1981 tax law will thus not even replace the federal revenues that nonprofit organizations themselves will lose thanks to the budget cuts, so that these organizations may not even be able to maintain their existing levels of activity. In fact, the tax and budget portions of the Economic Recovery Program combined, even with all religious giving included, will reduce nonprofit organization revenues by $3.4 billion below 1980 levels in 1982, by $5.8 billion below those levels in 1983, and by $4.7 billion in 1984.

With giving for sacramental religious purposes excluded,[7] these reductions are even more striking, totaling $4.7 billion in 1982, $8.1 billion in 1983, and $9.2 billion in 1984, for a total reduction of $23.5 billion for the entire 1981-84 period. It is important to note, moreover, that these figures represent reductions not in relation to projected revenues under the January budget or prior tax law, but in relation to *actual 1980 levels*.

It should be clear from the evidence presented here that nonprofit organizations can anticipate a period of considerable strain as a consequence of the budget and tax policy changes recently adopted by the federal government. How severe that strain turns out to be, and how it actually affects nonprofit organizations, however, will depend on at least two sets of factors that can only be hinted at here.

The first set of factors concerns the way nonprofit organizations themselves respond. At a minimum, these organizations will have to renew their attention to careful management and efficient operations, though the savings available from this quarter are far from clear. Beyond this, changes will be needed in basic fund-raising techniques to adjust to the decline in available federal resources and the projected increase in the share of individual giving to be borne by lower- and middle-income persons. This may involve, among other things, greater reliance on direct mail or payroll-deduction approaches, as well as greater use of fees and commercial income for those organizations with a marketable product or service. With respect to all of these, however, care must be taken to make sure that the struggle for survival does not undermine the very qualities that make the nonprofit sector so important and unique.

Ultimately, however, the impact of the changes portrayed here will depend less on the reaction of nonprofit organizations than on the reaction of the public at large. It is worth repeating in this connection, therefore, that simulation models of the sort utilized here are built on the basis of behavioral patterns established over the past. Quite clearly, however, behavior can change in response to new circumstances. The real value of a simulation, therefore, may not be to *predict* the future, but to indicate more precisely than is normally possible where present trends will lead us if past patterns of behavior persist, and thus what scale and kind of change is needed if the indicated outcome is to be averted.

In the present case, our projections suggest a period of considerable economic stringency and decline for a wide range of private, nonprofit charitable institutions. If by identifying this probable outcome this report helps trigger the changes in behavior needed to avert it, it will have served a useful purpose. What should be clear, however, is that these changes will have to be substantial. □

FOOTNOTES

1. Data on the expenditures of the nonprofit sector in 1977 are from U.S. Bureau of the Census, *1977 Census of Service Industries*, SC77-A-53, Part I (January 1981), p. 53-1-3. Data on nonreligious private giving are from *Giving U.S.A.*, 1981 Annual Report (New York: American Association of Fund-Raising Counsel, Inc., 1981), pp. 27 and 29.

2. See, for example, Michael K. Taussig, "Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions," *National Tax Journal*, Vol. 20 (March 1967), pp. 1-19; Robert A. Schwartz, "Personal Philanthropic Contributions," *Journal of Political Economy*, Vol. 78 (November-December 1970), pp. 1264-91; Martin Feldstein, "The Income Tax and Charitable Contributions: Part I — Aggregate and Distributional Effects," *National Tax Journal*, Vol. 28 (March 1975), pp. 81-100; Lawrence B. Lindsey, "Alternatives to the Current Maximum Tax on Earned Income," paper presented at the Conference on Simulation Methods in Tax Policy Analysis, National Bureau of Economic Research, January 1981; James N. Morgan, Richard F. Dye, and Judith H. Hybels, "Results from Two National Surveys of Philanthropic Activity," in Commission on Private Philanthropy and Public Needs, *Research Papers*, Vol. I (Washington: Department of the Treasury, 1977), pp. 157-323; and Charles T. Clotfelter and E. Eugene Steuerle, "Charitable Contributions," in Henry Aaron and Joseph Pechman (eds.), *How Taxes Affect Economic Behavior* (Washington: Brookings Institution, 1981), pp. 403-466.

3. Under the 1969 law, foundations were required to pay out each year five percent of their assets or all of their earnings, whichever is larger. The 1981 law removes the "whichever is larger" clause, permitting a maximum five percent pay-out even when revenues exceed five percent.

4. A full specification of this model can be found in a technical appendix to this report available from The Urban Institute.

5. This result is all the more striking when compared to what would have occurred under the House Ways and Means Committee version of the tax bill. While this bill would have achieved similar overall tax reductions, it proposed to allocate them differently among income groups. As Table 12 shows, this would have translated into different changes in patterns of giving among these groups. In particular, instead of increasing by 2.2 percent as it does under the approved bill, the share of private giving contributed by the lower-income groups would have declined by 4.4 percent under the Ways and Means Committee bill. Similarly, while the share of giving accounted for by the upper-income groups would still have declined under the Committee bill, it would have declined only about half as much as it does under the bill that passed.

6. This figure is based on a comparison of the Reagan budget with the comparable Carter budget over the period 1981-84, in current dollar terms. See: Lester M. Salamon with Alan J. Abramson, *The Federal Government and the Nonprofit Sector: Implications of the Reagan Budget Proposals* (Washington: The Urban Institute, 1981), p. 39.

7. To determine non-sacramental religious giving, we computed the ratio of sacramental religious giving reported in *Giving U.S.A.* for 1980 to the total giving to religious organizations projected in our simulations for 1980, and then applied this ratio to the religious giving estimates we developed for the subsequent years.

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